



OFFICE OF THE
COMMISSIONER

STATE OF CONNECTICUT

DEPARTMENT OF REVENUE SERVICES



**TESTIMONY OF KEVIN B. SULLIVAN
COMMISSIONER
DEPARTMENT OF REVENUE SERVICES
FINANCE REVENUE & BONDING COMMITTEE
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Good morning Senator Daily, Representative Widlitz, Senator Roraback, Representative Williams and members of the Committee. Thank you for raising our agency bills which are part of the hearing today.

- SB 1214 was developed with an ongoing working group representing the private sector. It will streamline the process and protections with respect to non-resident contractors and the limited circumstances when such contractors are considered to be resident contractors.
- SB 1215, in Sections 1 and 2, changes the penalty for failure to renew cigarette licenses and for sale or possession for sale of less than three cartons of unstamped cigarettes from a criminal misdemeanor to a \$90 infraction payable by mail. This will actually reduce enforcement costs and increase timely collection outside of crowded court dockets that usually only result, after much delay, in a comparable court-imposed fine.

Section 3 makes it a violation to operate commercial motor vehicles using dyed diesel fuel other than as permitted by federal law. Dyed diesel fuel identifies federally tax exempt sales. Currently, when found during a DRS inspection in conjunction with DMV, violators may only be referred to the federal government. This bill will decrease tax evasion.

Section 4 establishes a sliding scale of penalties for failure to comply with required electronic tax filing. Penalties will now range from 10% capped at \$5,000 for the first failure to 10% with no cap for third and subsequent non-compliance. This creates an incentive to comply by setting a lesser penalty for first time non-compliance which is now 10% uncapped.

- SB 1217 is necessary to avoid a \$17.5 million revenue loss. As a consequence of the 2010 federal reinsurance reform law, states must standardize and establish reciprocity or no longer assess premium taxes on non-admitted insurers. We will be submitting some revised language for this one.
- SB 1218. Section 1 authorizes DRS to partner with one other willing state agency and create a pilot program requiring tax clearance before receiving any required license to do business in the state. Frankly, we should also be working with you next session to offset any state or quasi-public agency payment or benefit when a state tax deficiency remains unpaid. But this is a cautious good start and follows the experience of New York, Massachusetts and other states.

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Section 2, developed with the Attorney General and similar to SB 1155, allow limited disclosure and re-disclosure of certain taxpayer information. This is necessary in order to protect Connecticut's position in cigarette-manufacturer initiated arbitration under the state's Master Settlement Agreement.

Section 3 is needed in order to continue refund offsets and not jeopardize \$3 million in annual revenue.

Section 4 is a technical clarification to economic nexus for purposes of continuing to tax non-domestic corporations.

Section 5, clears up an anomaly and conforms permitted crediting of corporation business tax overpayments as is currently allowed for income tax payments.

Section 6 corrects legislation enacted last year to apply to payers of comparable non-payroll compensation as now applies to wage withholding.

Section 7, similar to other trust tax treatment under Section 12-424, holds the purchaser of a business responsible for the seller's withholding tax liability unless the purchaser gets a tax clearance from DRS.

Section 8 extends by three years the time for DRS to make a deficiency assessment against an employer that fails to include in reportable taxable wages any amount in excess of 25% of wages actually reported. The time for deficiency assessment is also extended by three years for pass-through entities that fail to report properly includable Connecticut-sourced adjusted gross income of any non-state resident member.

Sections 9 and 10, developed following a constituent concern raised by Representative Hoydick, extend sales tax exemption eligibility to specialized equipment for drivers with disabilities already installed at the time of sale or resale.

While I am here, there are other proposals being heard today that raise real concerns.

With all due respect, two of these bills are not what they appear to be. The first, SB 1213, is the worst. You will be told that this is a taxpayer's bill. In reality, it is a tax lawyer's bill and will only encourage greater tax evasion. Connecticut requires taxpayers to prove their case by clear and convincing evidence. Why? Taxpayers and tax lawyers, not DRS, control the evidence. And unlike other administrative appeals, taxpayers and tax lawyers in Connecticut already have the advantage of de novo review in court, unbound by the facts found and applied in administrative review.

DRS is not known to be unsympathetic in handling tax disputes. In fact, we are more often criticized for compromising cases in the best interests of the state rather than going to litigation. Passage of this perennial bill will have two results, neither is in the interests of all taxpayers or the painful budget choices you already face. Our costs and time spent on investigation, compliance and litigation will increase and require additional staffing. Alternatively, far less tax due will actually be collected and far more tax due will be contested.

If SB 1213 passes, we estimate the annualized fiscal loss from resulting tax evasion will be at least \$125 million annually. This will worsen state's severe structural deficit and require even more taxes from everyone else, and mostly those who do not have the means to afford a legal

challenge. This ain't broke and you do not need to fix it. I urge you to check about this bill with the Governor's Office and OPM as well.

As to the second suspect bill, HB 6623, something is broke. But that's not really why the proposed fix is in front of you. As to the data issue, DRS is fully prepared in the course of revising our tax forms to include a more specific required identifier for municipal residence. But the real issue here is not taxpayer data. It's influencing the data factors that drive state ECS spending.

It is true that the currency of population and income data for ECS is a problem because the federal government no longer provides reliable interim census updates. Therefore, the best answer is a reliable state-based, interim sampling for population, income and other factors that may be needed or useful.

HB 6623, however, will only substitute one skewed result for another. State personal income tax filer data is not a full or fair measure of wealth for determining per capita or median family income. The number of non-filers and business filers allocated as personal filers stacks the deck. Then, mixing new but inaccurate income data under this bill with old and unadjusted population data only makes matters worse.

Yes, there is a problem but there is also better way to go about fixing it. Governor Malloy has announced that, working with the Legislature and others, the entire ECS formula will be reviewed before next session. That's the best way and the right context to come up with a solution to this problem that is really a policy issue disguised as a data issue.

Finally, HB 6624, HB 6626 and probably some bills in the Commerce Committee would address issues of e-commerce taxability. This is a real, significant and complex issue. Real because the current un-level playing field is unfair to most in state competitors that have to add sales and use taxes to either their cost of doing business or consumer pricing. Significant because out-of-state and off-shore e-commerce is a huge and growing business sector. It thrives, in part because it operates in a netherworld of taxability and tax collectability. That's why companies like Amazon are engaged in a litigation death match all across this country.

That said, this is also a very complex issue and why even states that have passed similar legislation do not yet see any real economic or revenue benefit. Reliably, fairly and enforceably taxing the cloud-world of e-commerce state by state is far easier said than done. All the more so given problematic "nexus" that determines constitutionality under the federal Commerce Clause. There is a growing consensus that Amazon cannot successfully make a constitutional case to evade state taxation. But the problem is when will we know that from the courts?

So, while DRS supports what you want to do, let me offer an alternative and our assistance in making it a meaningful alternative. I am grateful to Representative Elyssa Wright who reached out to DRS early on about all of this. I have shared with her a roadmap for interim action by the Finance Committee that would position Connecticut successfully to pass comprehensive legislation next session, successfully defend it if challenged and actually make revenue gains and economic gains based on tax fairness and competitive fairness. With Representative Wright's permission, I will be glad to share that plan of action with the Committee leadership if it would be helpful.

Thank you for your time and attention. We will be happy answer any questions and comment further now or as you may request in writing.

